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Brazil: The Civilians Return to Power

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An Intelligence Assessment

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*ALA 85-10015
February 1985*

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An Intelligence Assessment

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This paper was prepared by [redacted]
[redacted] Office of African and Latin American
Analysis, with [redacted] contribution by [redacted]
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Brazil: The Civilians Return to Power

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Key Judgments

*Information available
as of 1 February 1985
was used in this report.*

Tancredo Neves, Brazil's first civilian president since 1964, inherits pent-up pressures for political change, an economy only now beginning to recover from a three-year recession, and a \$100 billion foreign debt. To his advantage, Neves, who will turn 75 in early March, is a broadly popular, skilled politician well known for his honesty and ideological moderation as well as his ability to build a consensus among such disparate groups as labor, business, and the political left. We expect Neves to exploit his skills and popularity to maintain a temperate, predictable course for Brazil.

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On the economy, Neves is publicly committed to high growth rates, but we believe he is unlikely to adopt policies that are substantially more expansionary than those of the outgoing government. In our view, his most important task will be to slow Brazil's accelerating inflation, and we judge he stands a better-than-even chance of succeeding by the end of the year as Brazilians become convinced that he is determined to deal with the underlying causes. We believe he will stress increased fiscal discipline, financial reform to strengthen the government's control over monetary policy, and a "social pact" between labor and business to contain wage and price increases. Neves probably will continue to implement the current IMF stabilization program so long as it does not threaten further recession.

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We expect no major departures by Neves from the military government's policy with regard to the country's foreign debt so long as Brazil's balance-of-payments performance remains favorable.

He will, however, almost certainly call for limits on interest rates and ask for Western understanding of the political implications of the debt issue. Barring adverse international economic developments, we expect Brazil's balance of payments to remain favorable at least through 1985, with Neves offering strong financial and tax incentives to exporters and maintaining a gradual devaluation of the cruzeiro.

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Still, Brazil's economy will be vulnerable to miscalculations on domestic policies and adverse international economic developments. There remains a danger that efforts by Neves to accommodate the views of all his advisers, including those espousing leftwing positions, could result in the adoption of expansionary policies, abandonment by Brasilia of its IMF program, and escalation of inflation to the 300- to 500-percent range. Or, a resurgence of foreign interest rates and an unexpected drop in industrial country economic activity could impair Brazil's ability to meet its debt obligations. In either event, the effects would diminish Brazil's chances for recovery, heighten prospects for a confrontation with foreign creditors, and weaken the civilian government's political base. []

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Assessing Neves's prospects for managing the economy is complicated by Brazil's rapidly changing political landscape, as military-imposed political structures are reshaped to facilitate civilian participation. For example, Brazil's constitution will probably be revised to permit direct presidential elections in 1988 or 1989. In the increasingly open political environment, Neves's consensus-building efforts will be especially vulnerable to the competition for influence among labor, the political left, and the Congress. []

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Despite the transition to civilian government, we expect the armed forces to monitor the Neves government closely, but we see little likelihood of military intervention in the political process during the first year or so of civilian rule:

- Most officers appear to recognize that their prolonged rule tarnished their public image and diminished Brazil's military capabilities, and they seem anxious to return to the barracks.
- Neves has overcome the military leadership's doubts about his ability to protect armed forces interests and to keep the economic recovery on track. []

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If Neves's economic policies result in rising social unrest or he submits to a leftist clamor for Argentine-like trials of former military rulers, armed forces leaders probably would exert direct pressure on the President. In our judgment, however, conditions would have to deteriorate gravely before the military would risk popular rage by forcing Neves from office. []

We believe Neves will continue the pragmatic, low-profile foreign policy that was favored by the former military government. We expect him to strengthen ties with other Latin American countries, to support the Contadora peace initiative in Central America, and to avoid involvement in East-West disputes. Relations with Communist countries will probably be unchanged, with Brasilia looking for commercial opportunities but remaining suspicious of Soviet and Cuban political intentions. Neves has publicly stated that he will not renew diplomatic relations with Havana any time soon. []

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We expect Neves, who has assured US officials of his good will toward Washington, to continue the military regime's efforts to strengthen bilateral relations. We believe his administration will share US concerns about Soviet and Cuban adventurism and Latin American drug trafficking. Nevertheless, [] he also sees potential bilateral irritants, especially on such issues as debt servicing costs, access to US markets, technology transfer, and nuclear proliferation. []

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Brazil: The Civilians Return to Power

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Introduction

Tancredo Neves, whose inauguration on 15 March ends 20 years of military rule, must contend with a range of sensitive political and economic issues. His major political challenge is to consolidate civilian control by forging an effective government and establishing a mechanism for direct election of his successor.¹ He will also have to deal with the conflicting agendas of newly assertive groups—labor, civilian politicians, and small business. In the economic sphere, labor, other interest groups, and most politicians desire a return to rapid economic growth and more equitable distribution of income. Efforts to advance these objectives, however, could jeopardize long-term economic growth and lead to confrontation with international lenders. While coping with these challenges, Neves will continually have to reassure military officers who, although anxious to return to the barracks, will be monitoring the government closely.

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What Neves Brings to Office

Neves brings to the presidency extensive experience and broad popular support that should ease the transition from a military to civilian government. His ties to traditional political groups, however, could eventually alienate those Brazilians expecting a broad-based administration.

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Experience and Popular Support

In our view, Neves comes to power with important strengths. A public figure for over 50 years, he has the political acumen necessary to prosper in the shifting currents of Brazilian politics. A recent US Embassy assessment portrays Neves as conservative, but not doctrinaire, and generally without strong ideological

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¹ Neves was elected indirectly by an electoral college composed of 686 delegates—the 548 members of the Brazilian Congress plus six electors chosen by the state legislatures in each of the 23 states.

commitments. Moreover, according to the Embassy, Neves's moderation, personal honesty, and understanding of the Brazilian "rules of the political game"—which prize compromise and consensus building over confrontation—have been keys to his success. He has achieved accommodations with a cross section of the Brazilian political elite, ranging from leftists to his military predecessors, without appearing to identify himself with any group. US Embassy reports portray him as methodical and cautious, making political decisions himself but only after extensive consultations. Neves, for example, made certain he would win the electoral college vote before saying publicly that he would run, according to the Embassy.

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The present political atmosphere should further bolster Neves's position. Opinion surveys have consistently indicated that he enjoys wide popular support. The transition, moreover, has taken place without the rancor that often has accompanied the transfer of power to civilians in other South American countries, such as Argentina. The military broadly accepts Neves and supports the transition, according to

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US Embassy reporting. most members of the armed forces believe the military's credibility has suffered from its prolonged tenure in power and its inability to sustain economic growth in the 1980s, as well as from widespread reports of corruption. US Embassy and

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are looking forward to the changeover so that they can focus on repairing their tarnished image and improving military capabilities.

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Liabilities

While Neves brings experience and popular backing to the presidency, he also brings some shortcomings. According to US Embassy reporting, his age—he will be 75 in early March—may work

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Tancredo Neves

An elder statesman who has been involved in politics for over half a century, Tancredo Neves will become Brazil's first civilian President in 20 years when he takes office on 15 March. Neves, a leader of the Brazilian Democratic Movement Party (PMDB), ran for the presidency under the banner of the Democratic Alliance, a coalition of centrists, leftists, and conservatives. Throughout the campaign he was able to capitalize on the already established public image of his character, one of a steady performer committed to the formation of national consensus as well as a shrewd professional with proven skills in using conciliation to achieve pragmatic goals. In our judgment, however, the wide popularity he enjoyed during the campaign can be attributed more to the national perception of a need for change than to his personality, which is neither dynamic nor charismatic.

Neves carries surprisingly little ideological baggage for a man who once had a "populist" image and served as Prime Minister under the leftist regime

ousted by the military in 1964. Today, the Brazilian press usually describes him as a moderate or even as a conservative. Some of his present appeal probably stems from his not having held appointive office under the military regimes. An early exponent and beneficiary of abertura (opening, or political liberalization), Neves won election in 1982 to the governorship of Minas Gerais state on the PMDB ticket. Subsequently, he supported the public movement calling for direct elections in the face of the military government's determination to retain the electoral college.

Neves is not without detractors. Some rightists have openly expressed fears that he might embark on a vendetta against the military for its alleged abuses of power while it was in office, even though Neves has publicly ruled this out. In addition, staunch anti-Communists have denounced the presence of leftists among his supporters.

Neves earned a law degree in social sciences from the University of Minas Gerais. Besides the prime-ministership during the early 1960s, he served as Minister of Justice and Internal Affairs in the 1950s and also as the head of the National Bank of Economic Development. During most of the period of military rule, he was a staunch opposition leader in the Congress, first as a member of the Chamber of Deputies and later as a Senator. He gave up the governorship of Minas Gerais last August in order to run for the presidency. Tancredo—as he is generally called by the public and the press—appears to be in good health at the age of 74. His English is limited.

against him because he is not a part of the generation of politicians that matured under the military and now longs for power. He is viewed by many of these people, especially those on the left, as too closely tied

to "establishment" politics, despite his role as opposition candidate. the US Embassy report that some of Neves's own confidants

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believe he will reassert the power of the pre-1964 political elites rather than draw on the advice of newer, younger political figures, even though many of them backed his bid for office. []

US Embassy [] reporting also portray Neves as reluctant to delegate authority. Further, although he consults widely, Neves often disregards advice and makes key decisions based on his own political instincts, according to US Embassy reports on discussions with some of his close associates. While this approach has worked well for him thus far as a politician, [] it could cause him problems as he assumes responsibility for running the country. []

Meeting the Economic Challenge

Even with his political experience and popular support, Neves faces a formidable challenge on the economic front. He inherits an economy that—despite some recent improvements—remains seriously troubled. Brazil's most notable gains in 1984 were a \$13 billion trade surplus and a modest 3.5-percent growth in GDP after three years of recession. Because this recent economic growth has been narrowly based on exports, however, many knowledgeable Brazilians have publicly stated that they believe the government must take action to broaden the recovery, especially considering prospects for slower growth of foreign sales in 1985 and the need to reduce unemployment. Inflation has stubbornly remained above 200 percent for a second straight year under Brazil's IMF stabilization program, contributing to further declines in real wages and critically needed investment. In addition, Brazil's \$100 billion foreign debt and higher-than-normal interest rates have produced an annual debt service burden that would absorb some 75 percent of export earnings without some form of debt restructuring arrangement. []

Neves's Priorities

Given the magnitude and visibility of Brazil's economic challenge, we believe Neves wants to launch his presidency with some major economic policy initiatives in order to distinguish his administration publicly from that of the military. []

The Military Legacy

The military leaves political office with a mixed record. Following a decade of harsh political repression, the military government has followed through on assurances made in 1979 that the then-incoming President, Gen. Joao Figueiredo, would complete the political liberalization process begun in the mid-1970s. The military also presided over a period of remarkable economic growth, dramatic modernization, and unprecedented prosperity. Between 1964 and 1980, Brazil's economy expanded at an average annual rate of 8.4 percent, the best performance recorded by any country in the world. In sustaining this growth, however, Brazil resorted to heavy foreign borrowing, driving up its foreign debt from less than \$4 billion in 1967 to \$100 billion in 1984. Moreover, inconsistent policy responses to growing financial difficulties, coupled with the effects of a global recession, contributed to soaring inflation and a drop in economic growth since 1980. []

Brazil's poor economic performance in recent years was a key factor in declining public support for the government, according to US Embassy assessments. In 1982 the military's political opponents made significant gains in direct elections for members of Congress and state and local officials. In the recent presidential race, Paulo Maluf, the government's candidate, was unable to gain significant popular or electoral college support. This assured a victory for Neves's broad-based opposition coalition—the Democratic Alliance (AD)—composed of his own Brazilian Democratic Movement Party (PMDB), various leftist parties, and the Liberal Front, formed by anti-Maluf dissidents from the military government's Social Democratic Party (PDS). []

[] Neves's highest economic priorities for 1985 are to strengthen growth and employment opportunities, reduce inflation, obtain what he considers a fair multiyear rescheduling of foreign debt, and promote a more equitable distribution of income. []

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Neves has touted resumption of growth as the centerpiece of the new administration's economic program. The task recently has been made easier by last year's export-led recovery, which should, in the view of the IMF, pick up speed in 1985, with GDP increasing on the order of 5 percent for the year. Neves has indicated publicly that he hopes to facilitate growth through a combination of eased monetary restraints for private industry, increased subsidies to agriculture, and new government investments in small-scale public works projects. In addition, [redacted]

[redacted] he wants to create more industrial jobs, raise real wages, and increase social spending to bolster domestic demand as well as promote more even income distribution. [redacted]

Reducing inflation has been described publicly by Neves as essential to Brazil's sustained recovery, and it probably will be the most difficult challenge facing him. In our judgment, inflationary pressures are likely to be especially intense during the early months of his administration because of the military government's relaxation of monetary controls at the end of 1984. To fight inflation in the near term until more fundamental measures can take effect, Neves has proposed an emergency "social pact" between business and labor to limit wage and price increases. According to the US Embassy, he believes such an agreement would change Brazilians' psychological expectations of continued ballooning prices—expectations that are widely thought to be an important component of inflation. [redacted]

For the longer term, according to US Embassy and press sources, Neves believes that the government must curb public-sector deficits to control inflation. To this end, he is reported to favor budget and tax reforms, divestitures of some nonessential state enterprises, and cutbacks in large-scale public projects. According to press reports, Neves's advisers will also seek to reduce production costs in the industrial sector as a way of depressing inflation. In view of Neves's commitment to wage improvement, however, we believe his most likely target will be interest rates. [redacted]

On the issue of Brazil's large debt repayment burden, Neves has consistently stated that he will seek restructuring of the foreign debt that would include lower interest rates and longer maturities. [redacted]

To accommodate foreign creditors, Neves has underscored his intention to continue stabilization measures agreed on by Brazil and the IMF for 1985, so long as they do not appear to be causing further recession. Difficulties will arise, nonetheless, in reconciling stabilization with the administration's planned growth-oriented policies. [redacted]

[redacted] Neves has indicated he would refuse to accept Fund requirements for a highly restrictive monetary policy. Brasilia's "letter of intent" recently approved by the IMF, however, obligates the new government to curb expansion of the monetary base this year to 60 percent, less than half the rise that occurred in 1984. [redacted]

Coping With Interest Group Pressures

We believe Neves's economic policy course will be challenged. Under a civilian government, we expect that major segments of Brazilian society with widely diverging interests will apply considerable pressure to shape economic policies in their favor. Several groups—including labor, civilian politicians, and small business—have had little impact on policymaking under the military and see new opportunities for

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enhancing their positions. Others who have wielded significant influence over the past 20 years will attempt to protect their interests; these include the technocrats directing public-sector economic activity, the amorphous middle class, and influential industrialists. []

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Neves, whose constituency spans all these groups, will probably look for ways to accommodate their competing agendas without undermining his economic plans. According to the US Embassy, he is especially concerned that the demands of labor for higher wages, together with business calls for improved profits, could add to inflationary pressures early in his administration. Hoping his proposed "social pact" will mitigate tensions, Neves has met a number of times separately with business and labor leaders, some of whom have indicated receptivity to the idea despite the lack of details to date on the program, according to the US Embassy. []

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Despite Neves's efforts, we believe that some contentious differences among interest groups will surface, especially on the issues of economic austerity and debt. Brazilian press reporting indicates that most civilian politicians (including many of those in Neves's coalition), organized labor, and the bulk of the middle class are far less willing than technocrats and powerful industrialists—the main beneficiaries of foreign loans—to accept additional sacrifices for the sake of fulfilling foreign debt commitments. Neves's own Brazilian Democratic Movement Party (PMDB) called for a debt moratorium and a break with the IMF during a period of particularly strained relations with foreign creditors in the summer of 1983. []

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Influence of Economic Advisers

As part of his effort to devise politically palatable economic policies, Neves apparently intends to revamp the policymaking machinery. [] he plans to abolish the "superministerial," economic policy making function of the government's Planning Secretariat and, unlike the military regime, to consult a wide spectrum of economic advisers representing the concerns of most interest groups. We believe his decisions will be influenced substantially by these people, partly because he lacks

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Labor and the New Government

Organized labor in Brazil—which embraced about 20 percent of the country's 44 million workers as of 1980—hopes to exploit the more open political environment under Neves to bolster its flagging fortunes. []

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Sharp ideological and personal rivalries, as well as the effects of the recent economic recession, have prevented labor from exploiting gains made in the early 1980s during the first phases of the military regimes' political liberalization. Moreover, ineffective leadership, declining union membership, and poor showings of prolabor candidates in the 1982 elections have left the unions on the fringes of the political process. []

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Moderate labor leaders have formulated modest agendas for the new government in an attempt to influence policy and intend to avoid confrontations, at least in the near term, according to US Embassy reporting. More militant unionists, led by the Workers Party (PT) under the leadership of Lula da Silva in Sao Paulo state, have pledged to oppose Neves, whom they view as little more than a continuation of military rule. They plan to press for wage hikes and increased autonomy from government controls over internal union affairs. The militants are likely to challenge Neves early in his administration on wage and other issues, but []

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[] the labor movement as a whole will exercise little leverage on the new government. []

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Neves, for his part, has done little to court the unions. Nonetheless, we believe he recognizes the need for labor peace if he is to deal effectively with triple-digit inflation. We expect him to consult with labor representatives on economic and social welfare issues and to make limited concessions. He probably will stop short of easing government controls on the unions that have helped prevent the militants from gaining control of the labor movement. []

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Business and the New Government

25X1 *Much of the private business community is looking ahead to the Neves administration with considerable optimism. [] Businessmen view Neves as a moderate, consensus-style, and highly popular politician who is likely to strengthen political and social stability in Brazil. According to press reporting, a number of Brazilian businessmen expect a more open policymaking climate and a much more active role for business in shaping government policy than was permitted during the 20 years of military rule. Neves, for his part, has encouraged these expectations by suggesting publicly that he will assign some important ministerial posts to people with business and banking backgrounds who have proved their ability to manage major enterprises. []*

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Business for the most part has strongly endorsed several major elements of Neves's economic policy platform, but has reservations about others. In particular, the President-elect's pledges to sustain an economic recovery and to shift greater productive responsibility from the public to the private sector have gained widespread business support. Business confidence that the new government will deal effectively with soaring inflation, however, has been slow to materialize. Although private-sector leaders were reassured somewhat by a major economic policy speech by Neves in December underscoring the need for fiscal and monetary discipline, they continue to forecast high inflation rates for this year. []

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25X1 expertise in economic affairs and partly because, according to a range of US Embassy and open reporting, he does not have strong ideological predictions that shape his economic policy views. []

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Two major groups of advisers are competing for his attention, according to the US Embassy. One group draws support from the new Liberal Front—formed by pro-Neves defectors from the military government's Social Democratic Party (PDS)—and is composed of moderates willing to follow orthodox policies

and expand Brazil's international economic ties. The other is more closely tied to the left wing of the PMDB and tends to be more unorthodox and nationalist in its policy approaches. []

We believe Neves will offer high-level government positions to representatives from both groups in order to hold together the broad coalition that elected him. [] we agree, however, that he will reserve key policymaking posts for his more moderate economic advisers, such as Francisco Dornelles who is both a former Finance Ministry official and a protege of Brazil's well-known conservative economist, Mario Simonsen. To placate leftist supporters, we believe Neves also will find places for some of Brazil's leading leftwing economists—such as academic Celso Furtado—but in less influential posts. []

Charting Brazil's Political Course

Also among Neves's major challenges will be the consolidation of democratic government and the establishment of mechanisms for the direct election of his successor. Careful management in this area, which includes reform of both the military-imposed political party structure and the constitution, is critical for ensuring long-term political stability. []

Political Party Restructuring

The emergence last summer of Neves's electoral coalition, the Democratic Alliance, and the turmoil generated within the Social Democratic Party by Maluf's candidacy have hastened the breakup of the party system created under military rule. While major realignments are under way, the ultimate shape of the party structure remains unclear and will depend far more on fickle personal alliances and regional politics than on ideological considerations, according to sources of the US Embassy. []

For the time being, we expect Neves to try to preserve the Democratic Alliance as an umbrella organization, if not a formal party, to support his policies in the Congress and prepare for the 1986 congressional and

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gubernatorial elections. His task will be difficult, however, as the different parties and groups within the Alliance begin to pursue their own political interests. His PMDB, for example, which holds about 40 percent of the seats in the Congress, has long been divided into moderate and left-of-center factions. The leftists have complained publicly about Neves's centrist orientation, and Neves has held extensive meetings with them to discourage defections, according to US Embassy reporting. [REDACTED]

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The old PDS has splintered into two parties under the weight of Maluf's unpopular and controversial candidacy, and we judge further divisions could occur. The pro-Neves dissidents who broke with the PDS to form the Liberal Front in mid-1984 formally converted their group into the Liberal Front Party (PFL) in December. US Embassy and press reporting indicates that the centrist PFL is more coherent ideologically than the PMDB and has a strong regional base in the northeast. It controls about 25 percent of the seats in the Congress. [REDACTED]

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[REDACTED] Key PFL members have told the US Embassy that the party will chart a moderate course and, at least in the near term, back Neves's legislative program. The remnants of the PDS, according to the US Embassy and press reports, will probably survive as a right-of-center opposition force. We believe there is likely to be considerable infighting in the PDS, however, as pro- and anti-Maluf forces battle for control of the party. [REDACTED]

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The left, also divided, is seeking to rebuild and, according to [REDACTED] US Embassy reporting, may present Neves with his earliest and stiffest challenge. Leonel Brizola, the governor of Rio de Janeiro, is likely to emerge as a key spokesman for leftist opponents of Neves's policies. Brizola now heads the Brazilian Democratic Labor Party (PDT), [REDACTED]

Other leftist organizations that could pose problems for the new civilian government include:

- The *Workers Party (PT)*. This party was formed in 1980 with the backing of unions in the industrial city of Sao Paulo. The PT is a militant group that has called numerous strikes. Headed by a charismatic labor leader, Lula da Silva, the PT thus far has had little success in expanding beyond Sao Paulo, where it controls dozens of local unions. The party plans a major rebuilding effort in coming months, according to the US Embassy.

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Constitutional Reform

Against this backdrop of political restructuring, Neves has stated that he intends to institutionalize civilian government by revising the military-imposed

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1967 Constitution. [redacted]
 there is broad popular support in Brazil for convening an elected constituent assembly that would establish a system of direct presidential elections. Such elections were advocated during 1984 by groups opposed to the military government, and a constitutional amendment providing for direct elections was almost enacted by the Congress in June. [redacted]

his course is correct. Although the military is ending its direct control of the government, we expect it to monitor the new civilian administration closely. While broadly supportive of the return to civilian rule and anxious to focus more directly on strictly military matters, the high command retained some doubts about relinquishing power to Neves right up to the time of the election, [redacted]

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Based on press reports, we believe other critical issues that are likely to be addressed by a constituent assembly include:

- Opening the political system to accommodate the expected party realignment.
- Shifting some political and economic power away from Brasilia to the states.
- Increasing Congressional prerogatives in policymaking. [redacted]

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According to press and US Embassy reporting, Neves supports a constituent assembly but, given the complexity and sensitivity of the issues, has indicated that he will move cautiously. He has decided not to convoke the assembly before 1986, and he does not envisage direct election of his successor before 1988. To hold the assembly sooner, Neves has argued publicly, would require dissolving the Congress at a time when the new administration will be trying to consolidate its position and win passage of key legislation. Moreover, he opposes any efforts to amend the constitution through congressional action and circumvent the need for a constituent assembly. Neves's advisers have also told US Embassy officials that he supports proposals for shifting some political and economic power from the central government to the states. He probably calculates that backing this concept will reinforce his political support—especially among Liberal Front Party leaders, who strongly endorse the idea. [redacted]

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Assuaging the Military

In addition to serious economic challenges and the need to establish a foundation for lasting civilian government, Neves will have to convince a nervous military establishment and intelligence officials that

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Neves's Foreign Policy

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[redacted] Neves plans no major departures from the military government's foreign policy. He intends to pursue low-profile, pragmatic policies driven more by economic than ideological considerations. [redacted]

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Sustaining Current Policies

We expect Neves—who US Embassy officials report has a solid grasp of foreign policy issues—to:

- Maintain Brazil's identification with the Third World and avoid involvement in East-West disputes.
- Support the Contadora peace initiative in Central America.
- Remain critical of superpower involvement in regional disputes.
- Build ties with other Latin American countries and adhere to a policy of nonintervention in their internal affairs. [redacted]

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On foreign economic policy, press and US Embassy reporting suggest that Neves will continue to emphasize the political nature of the foreign debt problem and to criticize high interest rates. He has also been critical of trade barriers in the West while at the same time backing protectionist measures at home. [redacted]

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Relations With Communist Countries

According to press and US Embassy reporting, Neves is distrustful of Communism. We expect no dramatic improvement in bilateral relations with the Soviet Union and its allies—including Cuba, which has had no diplomatic or commercial relations with Brasilia since the military assumed power in 1964. Neves has stated publicly that Cuba's aggressive export of revolution poses a threat to hemispheric stability and that he will not restore relations with Havana. At the same time, Brazil has long pursued trading opportunities in Communist countries, and Neves has given no signs that he intends to reverse this approach. [redacted]

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We believe Neves will build on the military government's efforts to strengthen ties with China. During 1984 at least six Brazilian delegations visited the PRC

Neves's Nuclear Policy

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Neves has said publicly over the last several months that he intended to review the military government's 1975 nuclear agreement with West Germany, which called for the construction of nine nuclear power reactors and Brazilian acquisition of nuclear fuel technology. Neves's intentions on this score, however, are unclear. On the power reactor program, for example, US consular officials in Rio de Janeiro report that a ranking Brazilian nuclear official familiar with Neves's views believes that the President-elect's review of the accord was cursory and that he plans no major changes beyond stretching out construction of the reactors. Some US Embassy officials, however, believe that Neves will make sharp cuts in the reactor program. [redacted]

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Neves has stated that he favors "nuclear independence," and we see little likelihood that he will cut back on Brazil's unsafeguarded, sensitive nuclear research projects. [redacted]

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[redacted] *We do not believe, however, that either Neves or the military favors building nuclear weapons.* [redacted]

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Neves has stated that he shares the view of many Third World leaders that international safeguards are discriminatory. We do not believe that he will bow to pressure to sign the Nuclear Nonproliferation Treaty. Nor do we believe that he accepts the application of comprehensive safeguards to the Brazilian nuclear program that would be required to bring into force the Treaty of Tlatelolco, which calls for a nuclear-weapons-free zone in Latin America. [redacted]

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in search of markets for commercial and military goods. The two countries agreed to exchange military attaches, and a nuclear cooperation agreement was also signed. According to the US Embassy, Neves's support for Brazil's current foreign policy direction and the need to bolster exports will work in favor of continued expansion of Sino-Brazilian relations. []

Outlook for the Next 12 Months

We expect Neves to steer a moderate course for Brazil for at least the next year or so, and we judge that he is likely to have the political clout to maintain such a course. Despite the indirect nature of his election, Neves enters office in a position of strength, because of his broad popularity, his acceptability to Brazil's military and political elites, and his demonstrated ability to negotiate and compromise with key political actors. Moreover, the public euphoria surrounding the election and the transition to civilian rule should help keep opponents in check and provide Neves with an initial honeymoon period to consolidate his control over the government. []

Staying the Economic Course

In our judgment, the civilian government is unlikely to make any radical changes in economic policy this year. We believe the new administration will make a determined effort to continue Brazil's stabilization program so long as the ongoing economic recovery is not jeopardized. Neves has acknowledged, according to the US Embassy, the importance of laying a proper foundation for future growth by reducing inflation, maintaining balanced foreign accounts, and lowering public deficits. Moreover, his recent performance as Governor of Minas Gerais testifies to his willingness to support austere budgetary policies. In addition, we believe Neves will want to maintain restraints this year to pave the way for a stronger recovery in 1986, when he would hope to reap considerable political gain in that year's scheduled congressional and gubernatorial elections. []

To help achieve stabilization objectives, we believe Neves's moderate economic policy team will seek greater fiscal discipline. The incoming government has affirmed its intention to implement the budget reforms prepared by the military regime to enhance government control over spending. It probably will

also take steps to reduce the pay and fringe benefit excesses that pervade the government bureaucracies and cut back nonessential large-scale public works projects. []

As a result, in our view, the odds are slightly better than even that the new government will succeed in slowing Brazil's accelerating price increases by the end of this year, although overall 1985 inflation may top 250 percent because of the effects of monetary expansion on prices in the first half of the year. We judge that Neves and his economic team will probably be able to exploit their expected honeymoon, as well as general popular concerns about inflation, to maintain the cooperation of business and most of labor during 1985. If Neves fully carries out the military regime's planned budgetary and financial reforms, in our view, he will also be in a better position to limit Brazil's monetary expansion, which would further lower inflation. Such a reduction would be likely to have positive effects on Brazil's investment, economic growth, and foreign payments position. []

Barring adverse international economic developments, Brazil's payments position this year should remain strong, in our judgment. Neves's economic team has publicly asserted its intention to maintain the current sizable foreign reserves. Accordingly, we believe the new administration will continue to offer major tax and credit incentives to exporters, especially those in industry. Neves probably will prefer to devalue the cruzeiro only gradually to soften the inflationary impact, but forced to choose, he is not likely to permit the currency to become significantly overvalued, which would make Brazil's exports less competitive. We expect that continued recovery in the West and some revival of demand in developing countries will combine with favorable government policies to lead to an increase in export revenues of 5 to 10 percent. We expect the export performance will enable this year's trade surplus to approach last year's record \$13 billion total, despite substantial increases in nonoil imports. Consequently, we believe Brazil's current account deficit probably will again be negligible. []

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We believe the new administration will comply with debt rescheduling agreements reached by the military regime. []

Neves and his economic team probably will occasionally publicly criticize the IMF and the banks about the terms they have imposed on Brazil, but we believe his administration is unlikely to take any unilateral steps toward breaking commitments. Should interest rates again rise substantially or foreign purchases of Brazilian goods decline, however, we believe Neves might push for a renegotiation to obtain more generous terms from creditor banks and governments. []

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Stable Civil-Military Relations

The armed forces will remain the most important political group in Brazil, but unless Neves dramatically shifts his posture toward the military or strays too far from the moderate course we expect him to steer—moves we regard as highly improbable—we see little likelihood of any military intervention in the political process during the next year. Hardline elements opposed to the turnover of power are being eased out, [] and we expect the Army high command to use routine promotion and rotation cycles to replace other potential troublemakers. As the Neves government takes hold, we expect both sides to continue their dialogue to diminish tensions and uncertainties. []

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Potential Vulnerabilities

While we have forecast a moderate, relatively successful first year for Neves, his ability to hold to a centrist course will depend both on his own political skills and the continued willingness of key actors to compromise on contentious issues. Although he has demonstrated his ability to juggle competing demands and build a consensus, we believe there is considerable room for miscalculation that could complicate policymaking, erode his political base, and intensify opposition to his administration sooner than we, or Neves, expect. On the political side, key variables to watch include:

- *Popular expectations and Neves's leadership style.*

The transition itself has generated high expectations that could be difficult to fulfill, leading to popular disenchantment if Neves fails to differentiate the policies of his administration from those of the former regime. Further, his reluctance to delegate authority could prevent him from examining policy alternatives and distract him from key issues.

- *Managing Congress.* Legislators, newly freed from the constrictions of military rule, are almost certain to demand a larger role in policymaking, especially on economic issues. Neves will face difficulties holding together a working majority in the Congress, and probably will have to make substantial concessions on key legislation. The political party realignment could also result in a splintered system that paralyzes the legislative process. Moreover, members of Congress and party chiefs, anticipating the 1986 elections, might be unwilling to identify too closely with the new government.

- *Coping with the left.* Leftists are unlikely to give Neves much breathing room. We believe Brizola will press relentlessly for limiting Neves's term to two years, arguing that he is a transition president without a direct popular mandate. Brizola, as well as other leftists, are also likely to attack the President's economic policy and may demand investigations into past military corruption and human rights abuses. Neves's leftist supporters could be especially susceptible to such appeals. Other leftist groups, including the Communist Party and MR-8, are also likely to intensify their political activity as they seek to exploit the more open environment.

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- *Containing labor.* Weak, divided, and lacking a clear agenda, organized labor nonetheless has the ability to carry out disruptive strikes in both urban and rural areas. Several moderate labor leaders have told the US Embassy that they have been disillusioned by Neves's resistance to their calls for more union autonomy. Moreover, the Embassy has indicated that moderate labor chiefs may be unable to control their rank-and-file members, who appear increasingly influenced by leftists. According to US Embassy and press reporting, leaders of the Workers Party in Sao Paulo intend to oppose a "social pact" with business and the government. Rural labor unrest in the northeast and in the interior of Sao Paulo state has also increased in recent months, according to press reports.

- *Military concerns.* The armed forces will watch for policy shifts that threaten their interests. They may, for example, be willing to tolerate some investigations into flagrant military corruption, but they

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would resist any broad formal inquiries into their activities while in power. They will also be sensitive to any indication of growing leftist influence in the government, shifts in foreign policy—especially any movement toward a rapprochement with Havana—or signs that Neves is unwilling to act firmly against leftist subversive activity or illegal strikes. In our view, there is some potential for military or right-wing violence, such as bombings, against the government, although the high command should be able to contain such outbreaks. [redacted]

On the economic side, in our view, Neves's success in managing the economy over the next year will depend largely on his ability to regain control over Brazil's accelerating rate of inflation. We remain concerned that efforts by Neves to accommodate the views of all his advisers, including those espousing leftwing views, could result in the adoption of inconsistent and misguided policies, such as highly expansionary measures to spur rapid domestically driven growth. [redacted]

[redacted] some Brazilian businessmen are concerned that Neves's principal moderate economic policy advisers may not receive sufficient political backing from the new administration, allowing the leftists to wield increased influence on policymaking [redacted]

Under these conditions, Neves's plans to stabilize prices would be undone. [redacted] many Brazilians already are skeptical about the new administration's determination to fight inflation and will be alert to its first signs of wavering. A decision by Neves to shift to expansionary fiscal and monetary policies would be likely to lead to a rapid escalation of price increases, perhaps resulting in annual inflation in the 300- to 500-percent range. We will closely monitor the government's performance in the face of pressures for substantially increased budget expenditures on subsidies, social programs, and wages and as an indication of the new administration's ability to control its fiscal accounts. A sharp rise in inflation would seriously weaken the civilian government's prospects for sustaining the recovery, further strain its relations with foreign creditors, and damage its political base.

On the international side, a resurgence of foreign interest rates and an unexpected drop in industrial country economic activity probably would swell Brazil's current account deficit some \$3-4 billion because of the adverse impact on debt service costs and export earnings. Although Brasilia could accommodate these adverse developments without great difficulty this year, mainly by drawing down its recently replenished foreign exchange reserves, it would be likely to come under considerable domestic pressure to take a more antagonistic position in its relations with its foreign creditors. [redacted]

Implications for the United States

[redacted] Neves has underscored his intention to continue the military government's efforts to strengthen ties with Washington. He has met several times with high-level US officials and assured them of his friendly intentions. [redacted]

We believe that, on balance, Washington's hemispheric interests will be enhanced by Neves's presidency. A moderate who is strongly committed to elected government, he will be a stabilizing force in the largest and most economically powerful country in South America. His emergence is also likely to hearten moderate political opposition groups in other South American countries, such as Chile, and foster cooperation between Brazil and the new civilian governments in Argentina and Uruguay. At the same time, we believe Neves is unlikely to allow Brazil to be used as a base for operations by dissidents from neighboring countries, such as Chile, Bolivia, or Paraguay.

The regional interests of Brasilia and Washington are likely to coincide in several key areas. Neves, for example, has already voiced public support for US efforts to curb illicit drug production and trafficking in Brazil and the region. Barring any dramatic

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changes in Brazil's external account situation, he is also unlikely to take a confrontational stance toward Western lenders on the foreign debt issue or support any efforts to create a cartel of Latin American debtor countries. In addition, Neves is publicly committed to supporting the Contadora initiative in Central America, although he is unlikely to seek a more active role for Brazil in that region. []

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On security issues, Neves is likely to share US concerns about Soviet and Cuban activities in the hemisphere and guard against efforts by those nations to expand their activities in Brazil or in vulnerable neighboring countries. We believe, for example, that, given the military's intense interest in Suriname, he will maintain the military government's economic and military aid programs in that country to forestall Cuban expansionism there. We judge that he probably could be persuaded to play a similar role in neighboring Guyana if Cuban activities there expand significantly. Neves probably would also welcome increased US-Brazilian cooperation in such areas as military training and doctrine, hoping that such programs would help distract Brazilian officers from internal politics as well as enhance their military capabilities. []

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Neves, however, will be operating in a much more open political environment than the military government faced, and domestic political pressures will probably lead him periodically to voice anti-US positions. []

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[] Neves may feel compelled to criticize US policy in Central America to accommodate his leftist supporters. For the same reason, he may occasionally speak out against foreign banks and business interests, accusing them of insensitivity to Brazilian concerns. []

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Bilateral relations, however, will be most vulnerable to tensions stemming from Brazil's economic difficulties, in our view. While Neves has indicated his intention to maintain good relations with creditors, signs of lender inflexibility or large increases in the

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US prime lending rate would likely prompt a sharp response. Similarly, if Neves's orthodox economic program fails to control inflation, we expect he would concede a larger policymaking role to his more leftist-oriented economic advisers, who clearly are inclined to be more nationalistic and unfriendly toward Washington. If these advisers begin to dominate economic policy, Neves might well move to increase Brazil's role in the Cartagena debtors group and become more supportive of collective resistance to the banks. []

Foreign investment and trade issues could also become irritants. Neves has said he will continue to welcome foreign capital, but there are indications—including his support of recent legislation protecting Brazil's infant computer industry—that he may require foreign investments to be more consistent with Brazil's national development strategy. He may insist that projects include technology transfer and not compete with indigenous operations. On trade issues, we believe Neves will press for expanded access to US markets and is likely to prove a tough negotiator. He also wants the United States to be more forthcoming in sharing weapons and space technology, according to US Embassy reports. Further, he will be sensitive to any US pressures to limit Brazil's lucrative arms exports or to place Brazilian nuclear research projects under international safeguards. []

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